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Volume Title: Foreign Trade Regimes and Economic Development: South Korea

Volume Author/Editor: Charles R. Frank, Jr., Kwang Suk Kim and Larry E. Westphal

Volume Publisher: NBER

Volume ISBN: 0-87014-507-X

Volume URL: <http://www.nber.org/books/fran75-1>

Publication Date: 1975

Chapter Title: Front Matter

Chapter Author: Charles R. Frank, Jr. , Kwang Suk Kim, Larry E. Westphal

Chapter URL: <http://www.nber.org/chapters/c4061>

Chapter pages in book: (p. -23 - -2)

**Foreign Trade Regimes
and Economic Development:
SOUTH KOREA**

Foreign Trade Regimes and Economic Development:

*A Special Conference Series
on Foreign Trade Regimes
and Economic Development*

VOLUME VII



NATIONAL BUREAU OF ECONOMIC RESEARCH
New York 1975

SOUTH KOREA

by **Charles R. Frank, Jr.**

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AND THE BROOKINGS INSTITUTION

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DISTRIBUTED BY Columbia University Press
New York and London

NATIONAL BUREAU OF ECONOMIC RESEARCH

*A Special Conference Series on Foreign Trade Regimes
and Economic Development*

To
the Memory of
Thomas F. Olmsted
1929-1975

Library of Congress Card Number: 74-82375
ISBN for the series: 0-87014-500-2
ISBN for this volume: 0-87014-507-X

Printed in the United States of America
DESIGNED BY JEFFREY M. BARRIE

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*Relation of the Directors of the National Bureau to
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Foreign Trade Regimes and Economic Development*

The individual country studies have not passed through the National Bureau's normal procedures for review and approval of research reports by the Board of Directors. In view of the way in which these studies were planned and reviewed at successive working parties of authors and Co-Directors, the National Bureau's Executive Committee has approved their publication in a manner analogous to conference proceedings, which are exempted from the rules governing submission of manuscripts to, and critical review by, the Board of Directors. *It should therefore be understood that the views expressed herein are those of the authors only and do not necessarily reflect those of the National Bureau or its Board of Directors.*

The synthesis volumes in the series, prepared by the Co-Directors of the project, are subject to the normal procedures for review and approval by the Directors of the National Bureau.

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Co-Directors' Foreword

This volume is one of a series resulting from the research project on Exchange Control, Liberalization, and Economic Development sponsored by the National Bureau of Economic Research, the name of the project having been subsequently broadened to Foreign Trade Regimes and Economic Development. Underlying the project was the belief by all participants that the phenomena of exchange control and liberalization in less developed countries require careful and detailed analysis within a sound theoretical framework, and that the effects of individual policies and restrictions cannot be analyzed without consideration of both the nature of their administration and the economic environment within which they are adopted as determined by the domestic economic policy and structure of the particular country.

The research has thus had three aspects: (1) development of an analytical framework for handling exchange control and liberalization; (2) within that framework, research on individual countries, undertaken independently by senior scholars; and (3) analysis of the results of these independent efforts with a view to identifying those empirical generalizations that appear to emerge from the experience of the countries studied.

The analytical framework developed in the first stage was extensively commented upon by those responsible for the research on individual countries, and was then revised to the satisfaction of all participants. That framework, serving as the common basis upon which the country studies were undertaken, is further reflected in the syntheses reporting on the third aspect of the research.

The analytical framework pinpointed these three principal areas of research which all participants undertook to analyze for their own countries.

Subject to a common focus on these three areas, each participant enjoyed maximum latitude to develop the analysis of his country's experience in the way he deemed appropriate. Comparison of the country volumes will indicate that this freedom was indeed utilized, and we believe that it has paid handsome dividends. The three areas singled out for in-depth analysis in the country studies are:

1. *The anatomy of exchange control*: The economic efficiency and distributional implications of alternative methods of exchange control in each country were to be examined and analyzed. Every method of exchange control differs analytically in its effects from every other. In each country study care has been taken to bring out the implications of the particular methods of control used. We consider it to be one of the major results of the project that these effects have been brought out systematically and clearly in analysis of the individual countries' experience.

2. *The liberalization episode*: Another major area for research was to be a detailed analysis of attempts to liberalize the payments regime. In the analytical framework, devaluation and liberalization were carefully distinguished, and concepts for quantifying the extent of devaluation and of liberalization were developed. It was hoped that careful analysis of individual devaluation and liberalization attempts, both successful and unsuccessful, would permit identification of the political and economic ingredients of an effective effort in that direction.

3. *Growth relationships*: Finally, the relationship of the exchange control regime to growth via static-efficiency and other factors was to be investigated. In this regard, the possible effects on savings, investment allocation, research and development, and entrepreneurship were to be highlighted.

In addition to identifying the three principal areas to be investigated, the analytical framework provided a common set of concepts to be used in the studies and distinguished various phases regarded as useful in tracing the experience of the individual countries and in assuring comparability of the analyses. The concepts are defined and the phases delineated in Appendix A.

The country studies undertaken within this project and their authors are as follows:

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| South Korea | Charles R. Frank, Jr., Princeton University and The Brookings Institution; Kwang Suk Kim, Korea Development Institute, Republic of Korea; and Larry E. Westphal, Northwestern University |
| Turkey | Anne O. Krueger, University of Minnesota |

The principal results of the different country studies are brought together in our overall syntheses. Each of the country studies, however, has been made self-contained, so that readers interested in only certain of these studies will not be handicapped.

In undertaking this project and bringing it to successful completion, the authors of the individual country studies have contributed substantially to the progress of the whole endeavor, over and above their individual research. Each has commented upon the research findings of other participants, and has made numerous suggestions which have improved the overall design and execution of the project. The country authors who have collaborated with us constitute an exceptionally able group of development economists, and we wish to thank all of them for their cooperation and participation in the project.

We must also thank the National Bureau of Economic Research for its sponsorship of the project and its assistance with many of the arrangements necessary in an undertaking of this magnitude. Hal B. Lary, Vice President-Research, has most energetically and efficiently provided both intellectual and administrative input into the project over a three-year period. We would also like to express our gratitude to the Agency for International Development for having financed the National Bureau in undertaking this project. Michael Roemer and Constantine Michalopoulos particularly deserve our sincere thanks.

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Acknowledgments

When Charles Frank was engaged by the Co-Directors of this series to write the book on Korea, he learned that Larry E. Westphal and Kwang Suk Kim were already at work on a parallel study sponsored by the World Bank. To avoid duplication, the three of them agreed to collaborate, and the present volume represents their joint efforts.

Kim did most of the research for chapters 2, 3, 4, and 5, and also wrote the first drafts. Westphal and Kim produced chapters 6 and 10, and Frank contributed the remaining chapters. All three authors participated in the planning of each other's work and in the revision of first drafts.

Much of the material in chapters 6 and 10 was drawn from the Westphal and Kim contribution to the World Bank study. Their essay, "Industrial Policy and Development in Korea," emphasizes the methodology of measuring effective incentives and contains considerably more detailed analysis than it was thought necessary to include in the National Bureau's series.

We are grateful to the World Bank and to Bela Balassa, editor of *Development Strategies in Semi-Industrialized Countries*, for permission to make use of the Westphal and Kim essay in this book. We are also grateful to Balassa for his helpful guidance at every stage of our research and for his comments on several draft chapters.

The authors thank Thomas Olmsted and his colleagues at the USAID mission to Korea for their full support and cooperation. They also acknowledge the Ford Foundation grant of 1971 that enabled Kim to spend a year at Princeton working closely with his coauthors. Upon his return home, Kim was named a senior fellow of the Korea Development Institute. The Institute and its

president, Mahn-je Kim, were very helpful to the authors. The Korean officials who offered their services are too numerous to be listed here.

The compilation of the 1955 input-output table in Chapter 10 was supported by grants from the University Committee on Research in the Humanities and Social Sciences and the Council on International and Regional Studies, Princeton University. Sae Min Oh of the Bank of Korea's staff oversaw the task. Much of the computation of the growth contributions was financed by the Research Program in Economic Development, the Woodrow Wilson School, Princeton University. The Research Program in Economic Development provided general assistance including office space, secretarial help, and research assistants. Northwestern University granted Westphal a quarter's paid leave to permit time for further computations and writing.

Hal Lary read each draft of this volume very carefully and made numerous suggestions which greatly improved the end result. Jagdish Bhagwati and Anne Krueger provided expert guidance and intellectual stimulation. They gave us many helpful comments on earlier versions of the manuscript. T. N. Srinivasan, who read the next to last draft, passed on a variety of useful ideas. All of our colleagues associated with the National Bureau project are to be thanked for the insight of their suggestions, which were offered at the group sessions on research strategy.

A special acknowledgment is due Alice Ann Navin, without whose valuable assistance, the input-output analysis and effective incentive calculations could not have been done so expeditiously. Rekka Nadkarni furnished expert and extremely valuable help to Charles Frank in the computer programming and analysis in chapters 8 and 9. Kyi-Ja Kang tabulated statistical materials and performed computations for Kwang Suk Kim.

Many draft chapters were typed by Dorothy Rieger of Princeton's Research Program in Economic Development. Claudette Simpson also helped with the typing of several revised chapters. The final draft was typed by Rosemary Taromino.

The authors alone are responsible for all errors and omissions.

Principal Dates and Historical Events in South Korea

- 1904 Effective takeover of government by the Japanese in Korea.
- 1910 Korea formally annexed to Japan.
- 1945 Liberation of Korea by American and Russian troops; country split along 38th parallel; U.S. military government installed in South Korea.
- 1947 First stage of land reform; properties expropriated after departure of Japanese landlords are redistributed.
- May 1948 National Assembly elections, rightist parties in the majority.
- July 1948 Syngman Rhee elected President of South Korea by the National Assembly.
- Aug. 1948 End of rule by U.S. military government.
- 1949 Second stage of land reform; expropriation and redistribution of land from farms greater than three chongbos (about three hectares).
- June 1950 Beginning of war between North and South Korea.
- Sept. 1950 General MacArthur lands with UN troops at Inchon.
- Nov. 1950 UN troops reach the Yalu River but are thrown back by Chinese troops who enter the war.
- March 1951 Seoul retaken by UN troops.
- July 1951 Peace talks begin at Kaesong; battlefield stabilized.
- July 1953 Korean War armistice signed.
- March 1960 Opposition parties walk out of National Assembly over charges of fraud.
- April 1960 Student demonstrations lead to resignation of President Rhee.

- July 1960 New National Assembly elections; Chang Myon chosen as prime minister by the Assembly.
- Jan. 1961 Devaluation of the won from 65 to 100 won to the U.S. dollar.
- Feb. 1961 Devaluation of the won from 100 to 130 won to the U.S. dollar.
- May 1961 Military coup from which General Park Chung Hee emerges as head of ruling junta.
- June 1961 Unification of the multiple exchange rate system.
- Jan. 1963 Return to multiple exchange rates.
- Oct. 1963 National Assembly elections followed by Assembly elections of Park Chung Hee as president.
- May 1964 Devaluation from 130 to 257 won to the U.S. dollar; exchange rate fluctuates.
- March 1965 Reunification of the multiple exchange rate system.
- Aug. 1965 Exchange rate pegged at 271 won to the U.S. dollar.
- Sept. 1965 Interest rate reform; loan rate on regular commercial bank loans raised from 16 to 26 percent.
- Jan. 1967 Controlled flotation of the domestic currency upward from 271 won to the dollar.
- May 1967 Reelection of Park Chung Hee as president.
- July 1967 Reform of the import control system by switch from the positive-list to a negative-list system.
- 1967 Tariff reform.
- April 1971 Third election of Park Chung Hee as president.
- June 1971 Devaluation from 326 to 370 won to the U.S. dollar; exchange rate pegged.
- 1971 Further tariff reforms.
- Jan. 1972 Exchange rate floated upward in controlled fashion from 370 won to the U.S. dollar.
- June 1972 Exchange rate pegged at about 400 won to the U.S. dollar.
- Aug. 1972 Financial reforms and initiation of price stabilization program.
- Sept. 1973 Further tariff reforms.